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C O N F I D E N T I A L PESHAWAR 000184

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SUBJECT: NWFP PLANS TO FINANCE SECURITY AND RECONSTRUCTION

CLASSIFIED BY: Candace Putnam, Principal Officer, U.S. Consulate Peshawar. REASON: 1.4 (d)

¶1. (C) Summary: The Northwest Frontier Province (NWFP) government finally has received the first tranche of a 24 billion rupees (USD 291 million) revenue transfer from the Pakistani federal government; it will spend half of this to support the planned 2,500 Elite NWFP Police force and double the Malakand police force. The rest will be used to add 2-3 wings to the Frontier Corps and another 100 platoons to the Frontier Constabulary. NWFP Chief Minister Hoti has also launched a bid to increase the province's share of national tax revenue during the upcoming National Finance Council meeting and is pressing to expand the NWFP's share of hydroelectric revenue from Pakistan's Water and Power Development Authority (WAPDA). If Hoti succeeds, it will allow the NWFP to further expand security forces, supplement donor funding for reconstruction of conflict-affected areas, and cover the gap in its hopelessly unrealistic 2009-2010 budget. End summary.

¶2. (U) In a series of initial courtesy calls by PO on key NWFP government policymakers, PO's interlocutors repeatedly raised the need for the province to increase the revenue required to improve law and order and fund reconstruction in conflict-affected areas. Meetings in which the issue was raised included courtesy calls on: NWFP Chief Minister Amir Haider Hoti, on August 25; NWFP Chief Secretary Javed Iqbal, on August 25; the ruling Awami National Party's NWFP chief Senator Afrasiab Khattak, on August 25; NWFP Inspector-General of Police Malik Naveed, on August 26; Frontier Constabulary Inspector-General Zafar Ullah Khan; NWFP Senior Minister Bashir Bilour, on August 27; and PaRRSA Director Shakeel Qadir Khan on September 1.

Promised Security Supplement Arrives

¶3. (SBU) Chief Minister Hoti confirmed to PO that the NWFP government had received the first tranche of a 24 billion-rupee (USD 291 million) revenue transfer from the federal to the provincial government. Half of the spending supplement, promised by President Zardari in June, would be allocated to the NWFP police and would fund the planned 2,500-strong "elite" force, along with a doubling of the numerical strength of the police in the Malakand division. The balance would be split between the Frontier Corps, which would be able to add an additional 2-3 wings (battalion equivalent) and the Frontier Constabulary, which would add an additional 100 platoons. Police IG Malik Naveed boasted to PO that the money going to the police would allow the recruitment of 6,000 additional police, along with several new barracks facilities in Mansehra, Hangu,

and Kohat.

¶4. (C) Chief Secretary Javed Iqbal told PO that this phased two-year transfer to the NWFP (unusual in Pakistani government interplay and the first transfer from the federal to the NWFP government since the ANP took office in February 2008) was most likely a reaction to the province's cancellation of its 2008-2009 Annual Development Plan in order to pay increased salaries to a police force plagued by low morale and increasing desertion. This had forced the federal government to take similar action to prove its seriousness in fighting terrorism.

Brinkmanship at the NFC

¶5. (C) Iqbal hoped that the cancellation would also strengthen the NWFP's case at the upcoming meeting of the National Finance Commission (NFC), which is planned for September and will redistribute the percentage of tax revenue going to the federal government and the four provincial governments. In preparatory sessions for the NFC meeting, the NWFP joined the other provinces in lobbying for a change of the revenue sharing formula; the NWFP is not guaranteed to win all it wants in this battle for resources. As the provincial government has, on the basis of the existing arrangement, assumed a transfer of 68 billion rupees (USD 825 million) in its 2009-2010 budget, such an increase would potentially add another USD 100 million in discretionary funds for the next fiscal year.

¶6. (SBU) The NWFP government's stance that the NFC should increase the NWFP's distribution of revenues has unsurprisingly been popular in the province, and the NWFP political parties have been struggling to outbid one another to take the most extreme position on how much extra money the NWFP should get. An all-parties meeting called August 27 took a much more confrontational stance on the percentage of overall revenue that the NFC should award the NWFP than that posited by Hoti and Iqbal. The NWFP government, however, appears to be using its stance on the NFC as a bargaining chip in a negotiation that promises even more potential funding for the province - the retrieval of arrears from the Water and Power Development Authority.

Collecting from WAPDA

¶7. (SBU) The provincial government has been threatening to boycott the NFC unless the federal government intervenes to force settlement of a long-running dispute between the NWFP government and WAPDA, the state-owned corporation which is the primary operator of hydropower generation facilities in Pakistan (the bulk of which are located in the NWFP). According to the operational contract concluded between the NWFP and WAPDA, the NWFP was entitled to a portion of the proceeds of the WAPDA facilities in the province, which according to the NWFP government was supposed to rise over time as WAPDA's revenues rose. Instead, WAPDA had paid the same amount to the NWFP government each year since 1985. Afrasiab Khattak told PO that the federal government had initially arbitrated the dispute between the NWFP government and WAPDA; WAPDA had refused to accept the arbitration's 2005 conclusion, and the NWFP government had taken the dispute to the courts.

¶8. (C) The arbitration tribunal had ruled that WAPDA owed the NWFP 110 billion rupees (USD 1.34 billion) in arrears. (By way of comparison, the total projected budgetary revenue of the NWFP for fiscal year 2009-2010 will be USD 2.57 billion.) If enforced, the judgment also would establish a new, higher annual payment by WAPDA to the NWFP government; Hoti optimistically estimated that this should be approximately 30 billion rupees (USD 364 million) instead of the current 6 billion (USD 73 million). Javed Iqbal told PO that he was reasonably sure that WAPDA would soon come to a settlement with the NWFP government rather than attempting to continue litigation, and in a September 1 press conference, NWFP Chief Minister Amir Haider Hoti stated that the NWFP was satisfied with the efforts that the federal government had made to facilitate a settlement with

WAPDA, indicating that such a settlement was imminent.

NWFP's Future is Hydrocarbons

¶9. (C) In the deeper future, Iqbal saw revenues from oil and gas production outweighing even the potential gains from a larger share of hydroelectric revenues. He noted that gas production in Kohat, Hangu, and Karak districts had just begun (he estimated 7.5 billion rupees - USD 90 million in revenues this year), but it was rapidly expanding. The NWFP government had asked the federal government for visibility into, and a percentage of, the revenue, but had not yet received a response; after the NFC and WAPDA issues were resolved, it would demand such a stake in the field.

¶10. (C) Comment: The NWFP government's receipt of the first tranche of Zardari's promised security assistance will allow it to move ahead with several needed security improvements and indicates the seriousness of the federal government in supporting the war on terrorism in the NWFP. It is difficult to determine how realistic the NWFP policymakers' projections may be for increasing other federal/WAPDA revenues, but the positive tone of PO's interlocutors has been a far cry from the complaints we have previously heard about lack of federal government support. All of these redirections of funds will come at the expense of other Pakistani government priorities (and it is unclear whether WAPDA could even pay its arrears). However, if the NWFP's gains even approach the numbers being discussed, they would allow the NWFP to cover its current deficit budget, provide for security contingencies, and support reconstruction efforts. A cash windfall also would allow the Awami National Party-led NWFP government to boost its diminishing popularity by delivering on promises to improve law and order and the quality of life.

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